down by the Bankruptcy Act and the special rules of practice prescribed by the Supreme Court, bankruptcy proceedings are to be administered in accordance with the general principles of equity.[18] While the creditors of a corporation will not be permitted to object where the directors file a voluntary petition in bankruptcy,[19] yet in some cases it is reasonable to allow the stockholders to do so[20] for their relation to the corporation is more intimate than that of the creditors. The latter's sole claim is that the assets be kept unimpaired.[21] The former has a legally recognized interest in the life and welfare of the corporation.[22] Proceedings in bankruptcy do not deplete the corporate assets, but they do, usually, seriously injure, if not practically destroy, the corporation as a going concern. On equitable principles, therefore, and on analogy to cases where equity permits stockholders to sue or defend on behalf of the corporation whose directors fraudulently refuse to do so,[23] the bankruptcy court might well allow the stockholders to intervene where the directors are frauduently, and in utter disregard of the corporate welfare, petitioning it into voluntary bankruptcy, and might, to prevent the unconscionable exercise of a legal right, refuse to entertain such a petition.

LIABILITY OF A *DE FACTO* CORPORATION IN TORT. — Although, broadly speaking, a corporation exists *de facto* whenever associates assume without authority to act as a corporation,[1] the courts have rarely treated a group which has taken no further steps as more than a partnership.[2] But when there is a colorable compliance with a law authorizing incorporation, followed by purported corporate action, a *de facto* corporation exists in a restricted sense.[3] Here in certain cases and in favor of persons

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[18] *In re* Kane, 127 Fed. 552 (7th Circ., 1904); *In re* Broadway Savings Trust Co., 152 Fed. 152 (8th Circ., 1907); Zeitinger *v.* Hargadine, etc., 244 Fed. 719 (8th Circ., 1917); Bardes *v.* Hawarden Bank, 178 U. S. 524 (1900). See 1 COLLIER, BANKRUPTCY, 12 ed., 25; BRANDENBURG, BANKRUPTCY, 4 ed., § 10.

[19] *In re* Guanacevi Tunnel Co., 201 Fed. 316 (2d Circ., 1912); *In re* Lachenmaier, 203 Fed. 32 (7th Circ., 1913); *In re* United Grocery Co., 239 Fed. 1016 (S. D. Fla., 1917). See BRANDENBURG, BANKRUPTCY, 4 ed., § 60. And see 2 ST. LOUIS L. REV. 97.

[20] Zeitinger *v.* Hargadine-McKittrick Dry Goods Co., *supra*. For a discussion of that case and the right of the stockholders to intervene in opposition to a petition filed by the directors of a corporation, see 3 So. L. Q. 53–57.

[21] See N. J. Ins. Co. *v.* Meeker, 37 N. J. L. 282, 300; Atwater *v.* Manchester Savings Bank, 45 Minn. 341, 346, 48 N. W. 187, 189 (1891).

[22] Beal *v.* Essex Savings Bank, 67 Fed. 816 (1st Circ., 1895); Storrow *v.* Texas Mfg. Assoc., 87 Fed. 612 (5th Circ., 1898); Bijur *v.* Standard Distilling & Distributing Co., 74 N. J. Eq. 546, 70 Atl. 934 (1908).

[23] Hawes *v.* Oakland, 104 U. S. 450 (1881); Bronson *v.* LaCrosse R. R. Co., 2 Wall. (U. S.) 283 (1863). See *In re* Swofford Bros. Co., 180 Fed. 549, 553 (W. D. Mo., 1910).

[1] Appleton Mutual Fire Insurance Co. *v.* Jesser, 5 Allen (Mass.), 446, 448 (1862). "But when . . . persons were found . . . actually exercising the corporate powers, . . . they constituted a corporation *de facto*."

[2] Bradley Fertilizer Co. *v.* So. Publishing Co., 1 Misc. 512, 17 N. Y. Supp. 587 (1892); Harrill *v.* Davis, 168 Fed. 187 (8th Circ., 1909).

[3] Von Lengerke *v.* New York, 150 App. Div. 98, 134 N. Y. Supp. 832 (1912); Meramec Spring Park Co. *v.* Gibson, 268 Mo. 394, 188 S. W. 179 (1916); Spahr *v.* Farmers' Bank, 94 Pa. St. 429 (1880); Tulare Irr. Distr. *v.* Shepard, 185 U. S. 1 (1902).

acting in *bona fide* reliance upon the corporate existence,[4] the same results are predicated as if the attempted incorporation had been successful. The extent of this doctrine is in much dispute, and the authorities are not clear whether it applies to the case of a tort by the agent of such a body.[5] But a recent New Jersey case [6] goes further, holding a *de jure* corporation liable for the tort of an agent of associates who had not colorably complied with the terms of the incorporation statute.[7]

A rigid rule appears in many *dicta* [8] that every *de facto* corporation in the narrower sense above is to be recognized by the courts as a legal unit, though a somewhat inferior one because destructible at the will of the state.[9] This rule fixes a definite level of attainment below which no legal unit, however inferior, can exist or act with corporate significance.[10] Only the *de facto* corporation above that level can be a legal unit, or be liable for its agent's torts. Upon this theory the principal case is clearly not supportable.

But this point of view, it is submitted, is unsound, infringing on the one hand an admittedly exclusive power of the legislature to create corporations[11] and on the other hand failing to explain many of the adjudicated cases, where the courts have refused to permit collateral attack upon corporations not *de facto* in the restrictive sense.[12] It seems, therefore, preferable to say that a *de facto* corporation is never a legal unit,

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[4] See Edward H. Warren, "Collateral Attack on Incorporation," 20 HARV. L. REV. 456, note 13 (4).

[5] The authorities upon this subject are few. The balance, however, seems to favor tort liability. Demarest *v.* Flack, 16 Daly 337, 11 N. Y. Supp. 83 (1890); Howard *v.* Long, 142 Ga. 789, 83 S. E. 852 (1914); Lamming *v.* Galusha, 81 Hun 247, 30 N. Y.; Supp. 767 (1894). See Chicago R. R. Co. *v.* Glenny, 175 Ill. 238, 51 N. E. 896 (1898) Pinkerton *v.* Pa. Traction Co., 193 Pa. St. 229, 44 Atl. 284 (1899). But *cf.* Smith v. Warden, 86 Mo. 382 (1885); Vredenburg *v.* Behan, 33 La. Ann. 627 (1881). And in criminal prosecutions, collateral attack is denied. U. S. *v.* Amedy, 11 Wheat. (U. S.) 392 (1826).

[6] Frawley *v.* Tenafly Transportation Co., 113 Atl. 242 (1921). For the facts of this case, see RECENT CASES, *infra*, p. 203.

[7] 1896 N. J. COMP. STAT., p. 1604, § 10. The statute provided that an incorporating body, which had recorded its certificate with the county clerk, would become a corporation upon the date of filing said certificate with the Secretary of State. The defendant's certificate was recorded the day after the accident, and filed four days later.

[8] Heaston *v.* Cincinnati R. R. Co., 16 Ind. 275, 278 (1861); Hasselman *v.* U. S. Mortgage Co., 97 Ind. 365, 368 (1884). See Snider's Son's Co. *v.* Troy, 91 Ala. 224, 230, 8 So. 658, 660 (1890).

[9] See Charles E. Carpenter, "*De Facto* Corporations," 25 HARV. L. REV. 625.

[10] This level of attainment is determined by the courts in each jurisdiction. It might be possible to modify the rule, and consider the level as varying according to the circumstances of the case. This would require a reasonable consideration of the interests involved in each case, but would differ from the view contended for, *infra*, in that the common-law principle and legislative policy there mentioned would not be recognized as factors necessary to be overcome.

[11] See People *v.* Mackey, 255 Ill. 144, 156, 99 N. E. 370, 374 (1912). But see MORAWETZ, PRIVATE CORPORATIONS, §§ 652, 744; MACHEN, MODERN LAW OF CORPORATIONS, §§ 1, 19. See also Robie *v.* Sedgwick, 35 Barb. (N. Y.) 319 (1861).

[12] Baltimore R. R. Co. *v.* Fifth Baptist Church, 137 U. S. 568 (1890); St. Louis R. R. Co. *v.* Belleville City R. R. Co., 158 Ill. 390, 41 N. E. 916 (1895); M. E. Union Church *v.* Pickett, 19 N. Y. 482 (1859).

but will be treated like one when public policy [13] or fairness between the parties [14] call with sufficient strength for a departure from common-law principles and from the legislative policy manifested in the requirements for incorporation. In proportion as the associates fail to attain those requirements the legislative policy against treating them as incorporated becomes stronger, so that more powerful considerations of policy or of fairness are necessary to override it. But no bright line can be drawn between those *de facto* corporations which will and those which will not for some purposes be treated as legal units. In each case opposing considerations are to be balanced.

This balance must be applied in three situations in fixing responsibility for the tort of an agent of a *de facto* corporation. First: the injured party may sue the associates individually. He has not consented to deal with them on a corporate basis, and clearly they should not be able to assert against him the corporate feature of limited liability to which they have not entitled themselves by compliance with the conditions precedent of the statute. Any consideration of fairness to the associates who acted in the belief that their liability was limited is overweighed by the hardship on the plaintiff in forcing him to bring a new action, on which the Statute of Limitations may have run, against a possibly insolvent *de facto* corporation. *A fortiori* is it insufficient to override common-law principles, especially when, because of a material failure to meet the statutory requirement, the legislative policy against treating the associates as incorporated is strong.

Second: the plaintiff may sue the *de facto* corporation. If he does so relying on the validity of its incorporation, the associates should not be permitted to disclaim corporate capacity to his prejudice, and he should share equally with other creditors who have dealt with the associates in the same reliance. But even if he knows at the time of suit that the corporation is not *de jure*, he should recover subject only to the rights of creditors who in good faith have dealt with the associates on the corporate basis and whose rights are therefore limited to the *de facto* corporate assets.[15] For if the plaintiff will accept a limited corporate liability in the place of a full individual liability, whether he sue the corporation or join the associates as defendants, is a mere matter of procedure; [16] and his choice to sue the corporation is eminently fair to the associates, who are thereby actually conceded the benefit of

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[13] Especially where the *de facto* corporation has acted as a conduit of title. Society Perun *v.* Cleveland, 43 Ohio, 481 (1885).

[14] This interest would be paramount where there have been dealings between the parties on a corporate basis, as in contract cases. See Edward H. Warren, "Collateral Attack on Incorporation," 20 HARV. L. REV. 456, note 33.

[15] Snider's Son's Co. *v.* Troy, 91 Ala. 224, 8 So. 658 (1890). See WARREN, CASES ON CORPORATIONS," p. 610, note.

Difficulty might arise where creditors of the associates attempt to levy on property of the *de facto* corporation as property of the associates, and thereby come into conflict with the creditors of the *de facto* corporation. If the latter have relied upon this property as assets of the corporation, and the former have not relied upon it as assets of the associates, the corporate creditors should prevail. If, however, both have relied upon it as assets of their debtor, they should share equally.

[16] This is the converse of the problem presented where the *de facto* corporation is permitted to sue in tort. Remington Paper Co. *v.* O'Dougherty, 65 N. Y. 570 (1875).

limited liability. How far these considerations should move the courts when there is very material departure from the requirements for incorporation is debatable, but the procedural convenience, avoidance of inquiry into details of incorporation, and fairness to all parties may well override a fairly strong legislative policy against treating the associates as though incorporated.

The principal case presents another situation. Between the commission of the tort and the bringing of the suit, the *de facto* corporation has become *de jure*. To allow recovery against the *de jure* corporation is to grant a right against its assets to parties who have a valid remedy elsewhere, to the prejudice of creditors whose claims were acquired by dealing with the new corporation and whose only remedy is, therefore, against those assets. It imposes a pre-natal obligation upon the corporation and is analogous to allowing recovery against it for the tort of its promoters, which is clearly not permitted.[17] The holding of the principal case is therefore indefensible.

RECENT CASES

AGENCY — PRINCIPAL'S LIABILITY TO THIRD PARTY IN CONTRACT — WHERE THIRD PARTY THINKS AGENT IS NOT WITHIN HIS AUTHORITY. — The plaintiff's agent had authority to make contracts without confirmation by his principal. The agent entered into a contract with the defendant on behalf of the plaintiff. In an action by the plaintiff on another transaction, the defendant seeks to recoup for breach of this contract. The court instructed the jury that unless the defendant knew that the agent had authority to contract without confirmation, and relied on such authority, there was no contract. *Held*, the instruction was erroneous. *North Alabama Grocery Co.* v. *J. C. Lysle Milling Co.*, 88 So. 590 (Ala.).

The case decides for the first time, it is believed, whether a good contract results when an agent and a third party purport to make a contract which the latter mistakenly believes not to be within the scope of the agent's authority. The result could clearly not be reached on grounds of estoppel. But, as is now generally recognized, the fundamental principle on which the law of agency rests is not estoppel, but identity, *viz.*, that the acts of an agent within the scope of his authority are the acts of his principal. See *Watteau* v. *Fenwick*, [1893] 1 Q. B. 346; *Kinahan & Co., Ltd.* v. *Parry*, [1910] 2 K. B. 389. The principal case is merely a logical application of this doctrine. Nor is the opposite result required by principles of contract, because of the belief of the third party that he was not entering into a binding obligation with anyone. In the face of his expressed intent to contract, his silent mental attitude is immaterial. See 1 WILLISTON, CONTRACTS, §§ 21, 22.

BANKRUPTCY — JURISDICTION OF FEDERAL COURTS — POWER OF THE DIRECTORS OF A CORPORATION TO FILE A VOLUNTARY PETITION AFTER THE APPOINTMENT OF A RECEIVER BY THE STATE COURT. — A corporation, by its directors, filed a voluntary petition in bankruptcy, and was at once adjudicated and a receiver appointed. It then appeared that a few days previous to these proceedings a state court of proper jurisdiction had, upon petition

[17] Stewart *v.* Mynatt, 135 Ga. 637, 70 S. E. 325 (1911).